BUILDING THE BASIC COURSE AROUND INTRA-FIRM RELATIONS

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I approach the basic Business Associations course with the premise that the entire course can and should be built around the theme of the interaction among the various groups that form the business enterprise. In the eyes of American corporate law, those groups are typically shareholders, directors and management, while other important actors with an interest in corporate performance (such as non-management employees, the community at large, creditors, consumers, and the like) are essentially treated as outsiders to the business enterprise.[1] This treatment has been the subject of much criticism in recent years, and a review of this criticism can form an integral part of the basic course.

For example, "communitarian" corporate law scholars are critical of the notion of shareholder primacy envisioned by the traditional legal model and argue that the corporation should serve the interests of a variety of stakeholders, rather than single-mindedly attempting to further shareholder welfare.[2] The communitarian

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[1] WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE 12 (6th ed. 1996) (noting that a model that views "the owner as the core of the enterprise and the other elements as inputs hired by the owner and having only a very narrow interest in the enterprise" conforms with "traditional, established legal doctrine"); Lawrence A. Cunningham, *Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance*, 84 CORNELL L. REV. 1133, 1136-38 (1999) (noting that in U.S., managers (including directors) and shareholders constitute the corporation and that rights of other participants, such as creditors, employees and consumers are governed by contract law or by other legal regimes); Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283, 283 (1998) ("Corporate law is primarily about shareholders, boards of directors and managers, and the relationships among them.").

[2] *See, e.g.*, Greenfield, *supra* note 1 (criticizing exclusion of employees from traditional corporate law doctrine); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 585 (1992) (arguing that "constituency statutes are part of a trend suggesting a need for legal recognition of constituent interests within the corporate structure"); Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*,

approach is not without vociferous critics, however, and professors wishing to explore the debate in class should consider assigning excerpts from this ongoing discourse. A good start may be to assign portions of *Progressive Corporate Law*, edited by Professor Lawrence E. Mitchell,[3] and Professor Stephen M. Bainbridge's extended critique thereof.[4]

The analysis of the business enterprise as a cooperative effort is another modern trend. For example, Professors William A. Klein and John C. Coffee have argued in favor of a joint-enterprise approach that envisions the "relationships among creditors, suppliers, employees and owners . . . as ones involving contributions to a joint enterprise."[5] Similarly, much recent scholarship has advocated a "team production" model that envisions non-shareholder claimants as members of a team making firm-specific investments.[6] Perhaps most recently, Professors G. Mitu Gulati, William A. Klein, and Eric M. Zolt have proposed a firm model that views collaborative economic activity as connected bargains with regard to risk, control, return and duration, and rejects the concept of "ownership" and of a centralizing nexus.[7]

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78 CORNELL L. REV. 899, 902 (1993) (advocating expansion of existing fiduciary duty law to encompass obligations to employees); Marleen A. O'Connor, *Restructuring The Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189 (1991) (arguing that directors should owe employees fiduciary duty to provide adequate severance pay, job retraining, and other benefits when employees are displaced by corporate restructuring decisions).

[3] PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995).

[4] Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856 (1997) (book review) (criticizing progressive communitarian corporate law scholarship).

[5] KLEIN & COFFEE, *supra* note 1, at 12.

[6] *E.g.*, CHARLES R.T. O'KELLEY, JR. & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 8-11 (3rd ed. 1999); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); Charles R. O'Kelley, Jr., *Filling Gaps in the Close Corporation Contract: A Transaction Cost Analysis*, 87 NW. U. L. REV. 216 (1992); Eric Talley, *Taking the "I" out of "Team": Intra-firm Monitoring and the Content of Fiduciary Duties*, 24 J. CORP. L. (forthcoming 1999) (copy on file with author).

[7] G. MITU GULATI ET AL., MODELS, METAPHORS, AND THE CONTROL OF ECONOMIC ACTIVITY (forthcoming) (copy on file with author). This list is not intended as a complete survey of the relevant literature. Rather, my purpose is to demonstrate that many different models may be useful mechanisms for introducing students to the basic attributes of corporate law, and that the following exercise can be modified to fit any Business Associations class, regardless of the "theory of the firm" embraced by the particular professor. *Cf. id.* at 44-46 (discussing eight criteria to judge usefulness of legal models and urging scholars to exercise more care

My own approach to teaching the basic course is primarily through the use of a simple model that focuses on the separation of ownership from control (or, sometimes, the lack of such separation) in business enterprises, and the related agency costs.[8] This approach provides a simple and understandable framework that allows students to grasp the materials more easily. With only small variations, this framework can incorporate some or all of the other models that de-emphasize the role of shareholders as owners of the enterprise, as discussed below.

I begin the semester with a problem, "Of Wine and Winemaking" from *Corporations Law and Policy*.[9] The hypothetical posits a two-person firm in which the owner (the "principal") contributes all of the capital needed to start a business enterprise but does little or no work, and the employee (the "agent") contributes no capital, but performs most or all of the work.[10] I spend the first several classes elaborating on this example in order to introduce students to many of the core concepts in the law of business associations. This hypothetical thus serves as a framework for providing a general introduction to the course. As the semester develops, I return to each of these themes and concepts in more detail, constantly reminding students of the hypothetical two-person vineyard firm to ensure that they do not lose touch with the lessons learned in the first few weeks of the course.

I first discuss with the students the reasons that a relationship such as this may develop. In other words, why would our owner give up control to her employee? Similarly, if the employee is to perform all of the work anyway, why not be an owner himself and

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in reliance on models and metaphors).

[8] *See* Cunningham, *supra* note 1, at 1136 (stating that "[t]he key problem in U.S. and U.K. corporate governance is the separation of ownership from control resulting from the shareholder-manager dichotomy"). *But see* Bainbridge, *supra* note 4, at 862 (stating that "contractarianism offers a metaphor in which the separation of ownership and control is not a problem, but rather simply a necessary, and arguably unremarkable, attribute of the modern public corporation").

[9] LEWIS D. SOLOMON ET AL., CORPORATIONS LAW AND POLICY 17-18 (4th ed. 1998).

[10] The owner, Ann, has purchased a vineyard in Napa Valley, but she is unable to farm the land herself because she lives in Los Angeles. Consequently, Ann hires Bill, who has the necessary wine-making expertise and equipment, to farm the land and run the vineyard for her. *Id.*

reap all of the profits?[11] Students normally are able to identify a variety of reasons that the owner may not want to run the firm herself. For example, she may not have the necessary expertise to run this type of enterprise, she may not have the ability to run the business for other reasons (for example, she could live far away and therefore be a distant, and relatively inactive, investor), or she may have an interest only in the profits and not in the more time-consuming aspects of actually running a business. The students normally are able to identify rational reasons for the employee's behavior as well. For example, the employee may not have the capital to open his own business, or he may be risk-averse and unwilling to hazard the potential loss inherent in owning a business enterprise.

The next step is to highlight for the students in simple and familiar terminology how this separation of ownership from control immediately gives rise to possibilities for "shirking" by the agent and to demonstrate that the principal's attempts to eliminate this shirking can lead to substantial costs.[12] In other words, the

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[11] Professors who prefer to introduce collaborative models at the outset might characterize this same transaction somewhat differently. Rather than an "owner" who yields control to an "employee," this set of events could be characterized as a team or joint effort in which each party's firm-specific investment is contributed to the enterprise and the firm's output is non-separable, that is, "it is difficult to attribute any particular portion of the joint output to any particular member's contribution." Blair & Stout, *supra* note 6, at 249. *See generally* KLEIN & COFFEE, *supra* note 1; GULATI ET AL., *supra* note 7; O'Kelley, *supra* note 6.

[12] Lucian Ayre Bebchuk & Christine Jolls, *Managerial Value Diversion and Shareholder Wealth*, 15 J. L. ECON. & ORG. 487, 487 (1999) ("The agents to whom shareholders delegate the management of the typical large corporation have a variety of opportunities to transfer value from shareholders to themselves. These agents may take business opportunities presented to the firm and turn them to their own advantage; they may engage in classic self-dealing, selling assets to the firm or buying assets from it at non-arms'-length prices; they may trade in the firm's stock on the basis of inside information; or they may provide themselves with various perks not germane to their job."). The team production model also recognizes shirking as a potential problem in business associations, but focuses on the potential for shirking by both the principal and agent, rather than shirking by the agent alone, as in the traditional agency costs model. Blair & Stout, *supra* note 6, at 258-59; O'Kelley, *supra* note 6, at 219-20.

To say that the separation of ownership from control gives rise to *opportunities* for shirking does not mean that shirking will necessarily occur, a fact often noted by students. For example, students frequently raise arguments such as: "Why does all of this shirking have to take place? Doesn't anyone derive satisfaction from a job well done anymore?" This can lead to an interesting discussion of norms theory and behavioral economics and their role in the behavior of corporate actors.

principal has an incentive to work hard, because she bears all the risk of loss. Once she brings in the agent, however, there is a possibility of reduced efficiency because the agent, not bearing the risk of loss, does not have the same incentives to maximize production as does the principal.[13] I inform the students that the agent's shirking, and the principal's attempts to prevent it, are referred to as "agency costs" and explain that many of the corporate law principles that we will study during the semester are easily understood as attempts by the law to reduce the agency costs inherent in any organization where ownership is separated from control.[14]

I next discuss with students the various means by which the owner of our simple, two-person firm might seek to prevent the employee's shirking. I encourage students to recognize that each of the potential remedies is costly and imperfect, and that, as a consequence, once our owner decides not to run the firm herself, the efficiency ideal of the owner-managed firm is unlikely to be attained.[15] I normally discuss five common means by which the owner might attempt to control the employee's shirking:

Increasingly, scholars are questioning many of the underlying assumptions of economic analysis through reference to cognitive psychology and group norms. Some of this analysis may have important implications for the regulation of corporations and the securities markets. *See, e.g.*, Peter H. Huang & Ho-Mou-Wu, *More Order Without More Law: A Theory of Social Norms and Organizational Cultures*, 10 J. L. ECON. & ORG. 390 (1994) (applying psychological game theory to control of corruption in principal-supervisor-agent relationships); Robert B. Thompson, *Securities Regulation in an Electronic Age: The Impact of Cognitive Psychology*, 75 WASH. U. L.Q. 779, 780 (1997) (noting new paradigm that analyzes impact of cognitive psychology on economic principles that are relevant to study of corporate and securities law).

[13] KLEIN & COFFEE, *supra* note 1, at 36-37.

[14] Bebchuk & Jolls, *supra* note 12, at 488 ("Much of corporate law is addressed to the problem of managerial value diversion in its various incarnations."). Again, a team-production theorist would frame this scenario somewhat differently. Under that approach, the purpose of corporate law is not primarily to reduce agency costs, but to reduce the problems inherent in determining how economic surplus generated by the team enterprise should be divided. Blair & Stout, *supra* note 6, at 249-50; O'Kelley, *supra* note 6, at 219-20.

[15] KLEIN & COFFEE, *supra* note 1, at 36 ("[W]e must be careful about comparing the actual situation, with division of ownership and management, to the *mythical ideal of the owner-managed firm*. Once [the owner] decides, for whatever reason, that she does not want to manage the business, the standard of an owner-managed firm is unattainable.") (emphasis in original).

1. The owner could carefully supervise the employee herself. Although close personal supervision of her employee would reduce many shirking problems, it is also time-consuming and expensive and, perhaps, contrary to the reasons that she hired an employee in the first place (remember that one of the reasons the principal chose to give up control to her employee may have been that she did not want to devote the time to running a business enterprise).[16] Furthermore, if one of the reasons our owner hired an employee was due to her lack of expertise in the field, she may not be qualified to monitor the employee meaningfully.
2. The owner could also hire a supervisor to monitor the employee. This solution is imperfect, however, because it is expensive (she must now pay two employees rather than one), and the owner will still need some method to monitor the supervisor.[17] In other words, the supervisor is subject to the same temptation to shirk as the original employee, and the principal will have to monitor the monitor.[18]

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[16] SOLOMON ET AL., *supra* note 9, at 22.

[17] *Id.*

[18] I illustrate the circularity of this problem with a short reading from the noted legal theorist Theodore Geissel, better known as Dr. Seuss:

> Oh, the jobs people work at!
> Out west, near Hawtch-Hawtch,
> there's a Hawtch-Hawtcher Bee-Watcher.
> His job is to watch . . .
> Is to keep both his eyes on the lazy town bee.
> A bee that is watched will work harder, you see.
> Well . . . he watched and he watched.
> But, in spite of his watch,
> that bee didn't work any harder. Not mawtch.
> So then somebody said,
> "Our old bee-watching man
> just isn't bee-watching as hard as he can.
> *He* ought to be watched by *another* Hawtch-Hawtcher.

3. The parties could draft an employment contract that specifies the agent's duties and the sanctions to be imposed if he fails to perform those duties.[19] The problem with this monitoring method is that it is difficult to specifically define *ex ante* exactly what the agent's duties will be.[20] Contracting is also costly and time-consuming: there are substantial opportunity costs involved in negotiating and drafting the agreement, as well as legal fees.[21] Furthermore, enforcement through litigation or arbitration is costly, time-consuming and unpredictable.[22]

Given these problems, the parties could instead opt for an incentive-based employment contract that shifts some of the risk of loss to the agent.[23] For example, the contract could specify that the agent's salary will be partly dependent on profits or that he will receive a bonus if certain thresholds are passed.

The thing that we need is a Bee-Watcher-Watcher."
WELL . . .
The Bee-Watcher-Watcher watched the Bee-Watcher.
He didn't watch well. So another Hawtch-Hawtcher
had to come in as a Watch-Watcher-Watcher.
And today all the Hawtchers who live in Hawtch-Hawtch
are watching on Watch-Watcher-Watchering-Watch,
Watch-Watching the Watcher who's watching that bee.
You're not a Hawtch-Hawtcher. You're lucky, you see.

DR. SEUSS, DID I EVER TELL YOU HOW LUCKY YOU ARE? 26-29 (1973), *quoted in* Ronald Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 35 STAN. L. REV. 819, 933-44 (1981).

[19] SOLOMON ET AL., *supra* note 9, at 23.

[20] *Id.* In particular, bounded rationality may preclude business enterprises and their agents from completing the optimal contract necessary to eliminate shirking. As a result, "there must be some system of ex post governance, which includes some mechanism for detecting and punishing shirking." Stephen M. Bainbridge, *Participatory Management Within a Theory of the Firm*, 21 J. CORP. L. 657, 671 (1996).

[21] SOLOMON ET AL., *supra* note 9.

[22] *Id.*

[23] *Id.* at 26.

Many of the same problems and expenses previously discussed in connection with employment contracts are still present, however. For example, it may be difficult to draft *ex ante* a perfectly workable incentive contract.[24] If too much risk is shifted to the agent, the job may become unacceptably risky (I remind the students at this point that one of the reasons the agent is an employee rather than an owner is likely due to the reduced risk inherent in employee status). Similarly, if too little risk is shifted to the employee, the contract will not be effective.

In addition, it is difficult to correlate perfectly the incentive device to the employee's output. In other words, we want to insure that the employee receives added compensation only when the business does well because of his efforts and not because the market or the economy is good generally, or because there is a shortage of the product produced by the enterprise, in this case wine grapes, driving up prices industry-wide.

4. The parties may attempt to rely on reputation as a device to constrain the employee's shirking.[25] If the employee develops a reputation for shirking, he may be unable to find new employment if fired by the principal. However, reputational constraints may fail as effective monitoring devices in the corporate context because they depend on the agent being a repeat player.[26] If the agent is exiting the

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[24] KLEIN & COFFEE, *supra* note 1, at 22-23.

[25] SOLOMON ET AL., *supra* note 9, at 25.

[26] Reputational concerns may play a more effective role in forcing compliance with contractual obligations or informal social or business norms in more homogenous, closely-knit groups, or in groups whose information technology reduces the costs of monitoring and information transmission. *See, e.g.*, ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW

market, say to retire to Hawaii, then he may be unconcerned with maintaining his reputation and with his opportunities for future employment. Furthermore, in order for reputational influences to operate as an effective constraint on shirking, there must be some reliable means for the agent's bad reputation to become known to prospective employers. Otherwise, employers will be unaware of his reputation for shirking and his future employment prospects will remain unaffected by his bad reputation.

5. The parties may want to rely on legal rules to control shirking by the employee. This may be easy and effective if the employee's misbehavior takes the form of stealing from or lying to the principal, but the law may not adequately protect against the possibility of the employee's general laziness or bad decisionmaking.[27] The reasons for this are similar to those discussed in the contracting context: it is difficult to specify *ex ante* what constitutes good performance by the employee other than,

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NEIGHBORS SETTLE DISPUTES 267 (1991) (arguing that "close-knit groups generate norms that maximize the objective welfare of the group members"); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115, 140 (1992) (stating that "geographical concentration, ethnic homogeneity, and repeat dealing may be necessary preconditions to the emergence of a contractual regime based on reputational bonds"); Robert Cooter, *Models of Morality in Law And Economics: Self-control and Self-improvement for the "Bad Man" of Holmes*, 78 B.U. L. REV. 903, 909 (1998) (stating that "[t]he utilitarianism of small groups applies to people who interact repeatedly with each other, such as the Berkeley Chess Club, but not to categories of people who seldom interact, such as chess players in California").

Professor Stephen M. Bainbridge has argued that levels of norm compliance are likely to be low in the United States capital markets, due to the presence of "ethnically diverse and geographically dispersed actors, and their myriad types and sizes of firms and investors." *See* Stephen M. Bainbridge, *Behavioral Economics of Mandatory Disclosure* (unpublished manuscript) (on file with this author) (arguing that, except in small emerging markets with limited and homogenous business communities, norm compliance in capital markets is likely to be low).

[27] KLEIN & COFFEE, *supra* note 1, at 34-35.

> perhaps, a general mandate to use his best efforts to further the owner's interests.

I explain to students that most governance systems include elements of all five mechanisms in an attempt to constrain agent shirking. At this point I also ask the students to consider why business enterprises in which ownership is separated from control exist, given all of these agency costs associated with it. Students should recognize two primary benefits that flow from organizations, such as this one, in which ownership and control are separated. The first is specialization. In other words, this system of inactive owners who contribute all of the necessary capital to the business enterprise and active agents who contribute no capital to the business enterprise and bear little risk of loss allows the development of two classes of persons. One class has money, but little business expertise, and funnels capital into various business enterprises while knowing very little about those enterprises. The second class has little capital, but substantial expertise, and is able to run business enterprises in a way it could not if ownership was not separated from control.

The second potential benefit to the separation of ownership from control is diversification. In other words, by allowing owners to invest in a business without having any expertise in that business, a system in which ownership is separated from control permits principals to diversify, thus reducing their risk of loss. As a result, our hypothetical owner can invest in restaurants and record companies and railroads all at the same time without knowing anything about any of them. The hope, of course, is that any downturn in, for example, the record industry will be offset by gains in the restaurant business and vice-versa. On the other hand, an economy-wide recession, increased interest rates, or high inflation could result in losses to all of our owner's investments. This provides an opportunity to introduce students to the concept of systematic and unsystematic risks, and the idea of reducing unsystematic risk through portfolio diversification.[28]

I next extend the simple, two-person firm example to the large publicly-held corporation. I demonstrate that the owner of the firm is equivalent to the shareholders, again the "principal," and that the employee, the "agent," is equivalent to management. I clarify for students the fact that, although shareholders are the residual owners of the corporation, like our hypothetical owner, they are often passive and inactive, relying primarily on their agents to run the daily business of the corporation.[29] The students should also recognize that managers, like the employee in our example, are responsible for running the daily activities of the corporation and, consequently, have great control over the corporation and the finances of the owners.

Students should also see that, as in our two-person hypothetical firm, management has the same incentives and opportunities to shirk as our employee, and that shareholders often employ very similar devices in an attempt to control that shirking, with the same associated costs and limited success. I then review the five devices often employed to reduce shirking that were discussed earlier, showing students their application in a large-firm setting.

The first possibility for reducing managerial shirking would be for shareholders personally to supervise management. As in the hypothetical two-person firm, personal monitoring by the principal is often unsatisfactory because it is expensive, time-consuming and contrary to the reason that the shareholders delegated control to

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[28] Systematic risks are those risks that are not easily eliminated through holding a diversified investment portfolio. Unsystematic, or firm-specific risks, are those that can be easily diversified. Kimberly D. Krawiec, *Derivatives, Corporate Hedging, and Shareholder Wealth: Modigliani-Miller Forty Years Later*, 1998 U. ILL. L. REV. 1039, 1051.

[29] As previously noted, much current scholarship veers from the shareholders-as-owners model and, instead, views all corporate constituents as team players or members of a cooperative enterprise. *See supra* notes 6 & 7 and accompanying text; *see also* Margaret M. Blair, *Corporate "Ownership,"* BROOKINGS REV., Winter 1995, at 16 (stating that "[t]he problem with calling shareholders the owners of corporations is that the word 'owner' has such a powerful, almost moralistic meaning in U.S. culture. Its use in this context cuts off debate by implying that certain rights and prerogatives should, by the very nature of things, flow to shareholders"). *But see* Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm*, 50 WASH. & LEE L. REV. 1423, 1428 (1993) (noting that rejection of shareholders-as-owners model does not require adoption of team production model, but instead is consistent with contractarian model).

management in the first place. Furthermore, public shareholders are even more likely than our hypothetical small business owner to lack the necessary monitoring expertise.

Personal monitoring of management in the public corporation context is further complicated by the fact that the separation of ownership from control is even more severe than in our simple two-person firm. This, as all corporate law professors know but most law students do not, is due primarily to two factors.

First, corporate law removes most decisions regarding the operation of the firm from shareholder control.[30] Traditional wisdom asserts that the reason for this legal separation is that, in order for officers and directors of a public corporation to manage effectively, they must be given great flexibility and freedom without second-guessing from the shareholders—in other words, there must be a separation of ownership from control.[31] Professor Mark Roe, however, has vigorously challenged this view, arguing that the pattern of strong managers and weak owners observed in United States corporations is a political and path-dependent development, rather than an economic imperative.[32] Professor Roe compares corporations in the United States to those in Japan and Germany, where the separation of ownership from control is less severe. He concludes that the Unites States system of purposely separating ownership from control is attributable to social and political forces

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[30] *See, e.g.*, MODEL BUS. CORP. ACT §8.01(b) (1985) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors."); DEL. CODE ANN. tit. 8, § 141(a) (1974) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors."). Both statutes provide exceptions to this rule of mandatory board direction for companies electing close corporation status. *Id.* § 35; MODEL BUS. CORP. ACT § 20(b)(1).

[31] *See, e.g.*, Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 679 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972) (stating that "management cannot exercise its specialized talents effectively if corporate investors assert the power to dictate the minutiae of daily business decisions").

[32] Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641 (1996) (arguing that weak owners and strong managers observed in U.S. corporate system are not economic imperatives, but rather result of path dependency and political forces in the U.S. that feared large aggregations of wealth and power, and further comparing Japanese and German systems to U.S.).

that fear large concentrations of wealth and power, rather than to any greater economic efficiency associated with such separation.[33]

Second, unlike our hypothetical owner who personally hired the employee and can easily replace him, shareholders in a public corporation rarely play a meaningful role in monitoring and replacing management. This presents an opportunity to introduce students to collective action problems and the proxy process.[34] A review of section 14(a) of the Securities Exchange Act of 1934 and Rule 14a thereunder illustrates the fact that United States corporate and securities law overwhelmingly operates in a manner that favors "exit" over "voice," in contrast to the laws of many other countries. In addition, other legal barriers discourage both large block ownership and collective shareholder action.[35] The reasons for American corporate law's traditional preference for exit over voice is often the subject of interesting and extended debate, and students should be encouraged to evaluate whether United States regulators have opted for the best alternative.[36]

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[33] *But see* Stephen M. Bainbridge, *The Politics of Corporate Governance*, 18 HARV. J.L. & PUB. POL'Y 671 (1995) (reviewing MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOFS OF AMERICAN CORPORATE FINANCE (1994) and critiquing Professor Roe's theory).

[34] ROBERT CHARLES CLARK, CORPORATE LAW 389-94 (1986) (illustrating collective action problems among shareholders).

[35] For example, sections 13(d) and 13(g) of the Securities Exchange Act of 1934 (the "Exchange Act") require any person (defined to include two or more persons who act as a group for the purpose of acquiring, disposing of, or holding securities) who acquires more than five percent of the stock of a single class of any issuer to file a form 13D or 13G, respectively, with the SEC, thus subjecting the filer to liability under section 18 of the Exchange Act for any material misstatements or omissions in the filing. Similarly, owning more than a ten percent share in any issuer implicates the short-swing profits restrictions of section 16 of the Exchange Act. Block ownership could further trigger the issuer's poison pill or other defensive provisions with resulting negative consequences to the purchaser. *See* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 821-22 (1992) (discussing variety of legal impediments to collective shareholder action and large block ownership).

[36] Albert O. Hirschman developed the concept of exit and voice in large institutions in *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations and State.* Professor Hirschman, contrary to many economists who favor exit over voice, argued that a balance between exit and voice could enhance corporate efficiency for a variety of reasons. Professor John C. Coffee extended this idea by arguing that there is a trade-off between liquidity and control and that the United States system has opted for highly liquid markets in which shareholders do not exercise control. This is in contrast to many other economic systems (for example, those of Germany and Japan) that permit or encourage more shareholder control, but deny liquidity. John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor*

I normally conclude this analysis of shareholder monitoring with a discussion of institutional investors. Many commentators argue that institutional investors provide the hope of breaking the traditional cycle of shareholder apathy. There are many reasons for this belief. For example, although game theory predicts that self-interested shareholders will remain "rationally apathetic," game theory also suggests that repeat players, like institutions, may benefit from cooperation in ways not applicable to individual investors.[37] Others hypothesize that, due to the large size of their investments, apathy is not rational for large institutional investors, a theory that has been roundly criticized.[38] Still other observers argue that, even assuming that institutional investors have the capacity and desire to exercise more control in public corporations, institutional activism could have potentially negative consequences.[39]

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as Corporate Monitor, 91 COLUM. L. REV. 1277, 1281-89 (1991). This phenomenon may reflect the heavy reliance of the Unites States legal system on market forces, as opposed to legal regulations, as a constraint on management misbehavior, and it can form the basis of a discussion analyzing whether this reliance on market forces is justified. In fact, the remainder of this hypothetical highlights some of the shortcomings of both legal and market forces as an effective constraint on management, and can provide the background for further discussion of this point. *See infra* note 53 and accompanying text (discussing theory of the firm).

[37] Dean Robert Charles Clark beautifully illustrates the applicability of game theory to shareholder voting issues. In a clear and comprehensible example, he demonstrates that the shareholder confronted with the decision of whether to read and act on proxy materials faces a prisoner's dilemma in which ignoring communications to shareholders is the most rational alternative, regardless of the actions taken by other shareholders. CLARK, *supra* note 34, at 392-93. As with all prisoners' dilemmas, the cooperative choice benefits shareholders collectively but conflicts with each individual's self-interest in defecting. *See* WILLIAM POUNDSTONE, PRISONER'S DILEMMA 107 (1992) ("In a prisoner's dilemma . . . a player is always better off defecting, no matter what the other does."). When participants replay the prisoner's dilemma repeatedly, however, cooperation is more likely. *Id.* Because institutions, unlike most individual investors, are likely to be repeatedly confronted with the same proxy proposal (for example, to approve anti-takeover measures or re-value management options), they may be more likely than individual investors to cooperate and reach the best collective alternative, rather than defecting.

[38] *See, e.g.*, Black, *supra* note 35, at 821-22 (listing numerous incentives for institutional shareholder activism); *id.* at 815-19 (listing countervailing incentives for institutional apathy); Coffee, *supra* note 36, at 1281-89 (arguing that institutional investors highly value liquidity and, because there is always trade-off between liquidity and control, may be unwilling to accept greater corporate control through shareholder activism).

[39] *See* Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445 (1991) (arguing that, as agents themselves, managers of institutional investors should not necessarily be expected to adequately monitor other

As an alternative to personal monitoring, the shareholders could hire a supervisor to monitor management. I explain to the students that this, in fact, is the board of directors and emphasize that, like the supervisor in the hypothetical vineyard firm, the problem of monitoring the monitor still remains. There are additional reasons to doubt the efficacy of boards as constraints on management. For example, outside directors normally devote only a small amount of time to their directorial duties and often lack expertise in the industry of the corporation on whose board they serve.[40] As a result, they are highly reliant on insiders to provide information and expertise.[41] This is a good opportunity to explain to students the makeup of the board of directors and dispel any false notions that most boards of directors actually run the daily business of the corporation.[42] Instead, most boards operate much like the supervisor in the hypothetical vineyard firm, viewing their primary responsibility as monitoring management and replacing it when it does not perform well.[43]

The third device to constrain management shirking is an employment contract that specifies *ex ante* the agent's duties and the sanctions to be imposed if he fails to perform. While employment contracts are, of course, frequently used in connection

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agents); Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 799-839 (1993) (discussing political pressures and conflicts of interest that may decrease effectiveness of public pension funds as monitors). There is also a fair amount of empirical research on the effectiveness of institutional investor activism. *See* SOLOMON ET AL., *supra* note 9, at 591-92 (discussing empirical evidence of impact of institutional investors on shareholder monitoring).

[40] Elliott J. Weiss, *The Board of Directors, Management and Corporate Takeovers: Opportunities and Pitfalls*, *in* THE BATTLE FOR CORPORATE CONTROL: SHAREHOLDER RIGHTS, STAKEHOLDER INTERESTS AND MANAGERIAL RESPONSIBILITIES 36-38 (Arnold W. Sametz ed., 1991), *excerpted in* SOLOMON ET AL., *supra* note 9, at 623-24.

[41] *Id.*

[42] Board demographics are important for several reasons. First, the homogeneity of corporate boards may lead to an atmosphere of collegiality and deference to group norms, rather than to vigorous monitoring. *See* Bayless Manning, *The Business Judgement Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477, 1481-92 (1984) (discussing responsibilities and marketplace expectations of directors). Second, those who would urge a greater duty for corporations to further some social good, and greater board flexibility and power in order to achieve that goal, should bear in mind that boards of directors are overwhelmingly white, male, wealthy, and, I suspect, more politically and socially conservative than are the proponents of such a plan.

[43] Weiss, *supra* note 40.

with management, the same problems of expense, uncertainty and effectiveness that limited the utility of contracts in our two-person firm also apply here.[44] This does not mean that employment contracts are a useless waste of time. It does, however, indicate that contracts (like all of the monitoring devices discussed here, including legal rules) may be less than perfect means of aligning management and shareholder interests.

Corporate law attempts to alleviate some of the costs associated with such contracting through the use of enabling rules that act as a standard-form contract, establishing default rules that will govern the terms of the parties' relationship absent an agreement to the contrary.[45] This brings the class discussion to the fifth device used to reduce agency costs that was discussed in connection with the vineyard hypothetical: legal rules.[46]

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[44] An additional limitation on the ability of shareholders in some states to constrain their agents through *ex ante* contract is contained in a line of cases that prohibit shareholders in a close corporation from binding themselves to agreements that overly restrict the power of the board of directors. *See, e.g.*, Clark v. Dodge, 199 N.E. 641 (N.Y. 1936) (discussing common-law rule that shareholder agreements must not sterilize board of directors); Long Park, Inc. v. Trenton-New Brunswick Theatres Co., 77 N.E.2d 633 (N.Y. 1948) (holding that shareholder agreement giving one investor full authority to supervise operation of corporation was void because it sterilized board of directors).

More recent case law and legislative modifications have relaxed this rule somewhat in many jurisdictions. *See, e.g.*, Galler v. Galler, 203 N.E.2d 577 (Ill. 1964) (holding that comprehensive shareholder agreement was not void as against public policy and recognizing need for flexibility as regards close corporations); MODEL BUS. CORP. ACT § 7.32 (1985) (expressly authorizing seven specific categories of shareholder agreements that limit authority of board of directors and catchall provision authorizing all such agreements that are not contrary to public policy). I am grateful to Professor Stephen M. Bainbridge for suggesting this potential limitation on shareholder contracting power.

[45] *See* Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 7 (1990) (stating that "[t]he terms of the agency contract include the provisions of state law, which are regarded as a standard form that can be accepted by the parties or rejected either by drafting around the provision or by incorporating in another state").

[46] The extent to which corporate law is contractual in nature has been the subject of much debate. Professors Henry Butler and Larry Ribstein framed the debate as follows: "Contractarians view the corporation as a set of private contractual relationships among providers of capital and services. Anti-contractarians argue that the corporation is either not a contract at all, or at least is subject to more intrusive government regulation than other contracts." *Id.* at 3. The debate between contractarians and anti-contractarians as to the viability of market forces as effective managerial monitoring devices was documented in a 1989 symposium at Columbia University. *See* Symposium, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989) (debating extent to which corporations should be allowed to opt out of rules of corporate law by adopting charter

I encourage students to analyze many corporate law provisions, including the duty of care and duty of loyalty, as standard form (albeit, in the case of the duty of loyalty, non-waivable) contract provisions that attempt to deal with the vexing problem of specifying *ex ante* the extent of the agent's duties.[47] As in the case of our two-person firm, the law recognizes that it is easier to proscribe actions by the agent, such as lying, stealing or cheating, that involve disloyalty, than to deal specifically either *ex ante* or *ex post* with possible bad decisionmaking or general laziness.[48] Consequently, courts are much more willing to scrutinize carefully allegations of a breach of the duty of loyalty than to second-guess the wisdom of management decisions.[49] This may at least partially explain the reasoning behind the business judgment rule.[50]

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provisions to that effect and discussing which rules of corporate law, if any, should be mandatory). While it is true that some rules cannot be contracted around and that most shareholders do not have an opportunity to bargain explicitly for contractual provisions, the United States system is, nonetheless, far more flexible than that of many other countries and the manner in which courts often interpret and apply corporate law in the United States is often explicitly or implicitly contractually based. Furthermore, such criticisms seem to put the cart before the horse: in other words, to say that certain legal provisions operate as a standard form contract does not imply that such provisions are "bargained for," or fair, or should even be enforceable in all instances. As a result, I have found the analogy to standard-form contracts a useful pedagogical device, despite the ongoing debate as to the appropriateness of contractual comparisons. *See* Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403, 1411 (1985) (stating that "there is good reason to believe that because of institutional arrangements, investors in general cannot, and do not, freely and knowingly choose, or indeed comprehend, the terms of the 'contract' which binds management to serve them"); *id.* at 1414-15 n.29 (arguing that the mandatory nature of some corporate laws undermines contractarian theory of the corporation).

[47] Both the Delaware code and the Revised Model Business Corporation Act permit corporations to opt out of penalizing violations of the duty of care, but not the duty of loyalty, by including a provision to that effect in their articles of incorporation. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (1994) (permitting article provisions that reduce or eliminate director liability for violations of duty of care that do not involve acts or omissions committed in bad faith, intentional misconduct or knowing violations of law); MODEL BUS. CORP. ACT § 2.02(b)(4) (1979) (providing similar opt-out provision).

[48] *See* Bayer v. Beran, 49 N.Y.S.2d 2, 6 (N.Y. Sup. Ct. 1944) (suggesting that "the law will not hold directors liable for honest errors, mistakes in judgment").

[49] *See id.* at 6 (noting that business judgment rule "yields to the rule of undivided loyalty").

[50] *See* Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982) (listing as one underlying rationale of business judgment rule "courts recognize that after-the-fact litigation is a most imperfect device to evaluate corporate business decisions").

Given the obvious difficulties associated with specifically stipulating management's duties *ex ante*, shareholders, like the owner in the hypothetical two-person vineyard firm, may seek to employ an incentive-based contract that shifts some of the risk of loss to the agent. Most students are already aware that corporations frequently compensate management with stock options, but may be unaware of the role that incentive compensation ideally would play in reducing agency costs. As in our hypothetical vineyard firm, however, incentive-based contracts are not problem-free. For example, if management's salary is excessively incentive-based, the job may become unacceptably risky. On the other hand, if the contract calls for too little incentive-based compensation, it will be ineffective. In addition, it is difficult to correlate perfectly management's incentive compensation package to its performance, as demonstrated by the large number of executives earning "incentive" bonuses in years that the company under their stewardship loses money.[51]

Finally, in connection with the vineyard hypothetical, I introduced students to the idea that the parties in a firm may wish to rely on reputational considerations as a means of regulating agent behavior. In the public corporation setting, this is equivalent to the proposition that market forces and, in particular, the markets for corporate control and managerial labor may operate as effective constraints on management misbehavior.[52] One of the central debates in corporate law is the extent to which market forces effectively constrain management misbehavior and the extent to which the law must intervene, and this point in the hypothetical

[51] Cunningham, *supra* note 1, at 1137-38 (stating that "it is not uncommon, for example, to see senior executives earn staggering compensation despite mediocre or subpar performance"). It has been argued that perfect correlation is not merely difficult, but impossible. *See* Carlos Alberto Mello-e-Sowza, *Mortal Managers and Long Term Goals: An Imperfect Result*, 24 RAND. J. ECON. 313, 326 (1993) (formally proving that perfect incentive compensation system is not even theoretically possible).

[52] It is argued that the managerial labor market constrains management-shirking by relating firm performance to future employment opportunities. *See* Lucian Ayre Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1463-64 (1992) (noting that "[a] company's success may well affect the managers' opportunities for continued employment and promotion at the company as well as their future employment prospects at other firms").

exercise represents a good opportunity to introduce students to this debate.[53]

The theory behind the market for corporate control as a regulator of management behavior is that if management runs the corporation inefficiently or in a manner that benefits itself to the detriment of the shareholders, this will be reflected in a lower share price. This discounted share price makes the company ripe for a takeover and subjects management to significant risk of displacement. Consequently, so the argument runs, rational managers will run the corporation to the best of their abilities because it is in their own self-interest.[54]

The same factors, however, that rendered reputational considerations an imperfect monitoring device in the two-person firm setting may also reduce the effectiveness of the markets for corporate control and managerial labor in the public corporation setting. For example, during class discussion of the two-person vineyard hypothetical we explored the notion that, in most contexts, reputation only operates as an effective monitoring device if the employee is a repeat player, that is, if he plans to seek work again so that his reputation matters to him. The same is true in the

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[53] At this point I normally introduce students to the concept of the "Theory of the Firm," with readings from Professors Adolf A. Berle and Gardiner C. Means, various readings on contractarianism, and excerpts on other firm models, such as joint-enterprise, team production and communitarianism. *See* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932) (discussing concepts of ownership and control in corporate context and their effects on traditional economic theory); *see also* sources cited *supra* notes 2-7 (discussing collaborative and communitarian models). While this material is highly theoretical and often difficult for students to grasp early in the course, our extended discussion of the hypothetical vineyard firm and the parties with an interest in it paves the way for rich discussion, and the rewards of introducing students to this material early in the semester are great. Students normally very quickly identify with one "theory of the firm" or another, and it guides and motivates their thinking and decisions as to the purpose and wisdom of various laws and regulations throughout the course. Near the end of the semester, I return to this same material for a second time. At the end of the course, the students' understanding of this material is much greater, and they are normally surprised and pleased to discover the extent to which their knowledge and understanding grew during the semester.

[54] *See* Bebchuk, *supra* note 52, at 1462 (explaining that many commentators consider market for corporate control an important constraint on management misbehavior on theory that "because a takeover bid or a proxy contest may wrest from managers the control that is valuable to them . . . the prospect of such a bid or contest discourages managers from seeking value-decreasing rules"); Gilson, *supra* note 18, at 841-42 (describing market for corporate control and concluding that it is "an important mechanism by which management's discretion to favor itself at the expense of shareholders may be constrained").

public corporation setting. The markets for corporate control and managerial labor will only operate as effective threats to management if managers are concerned with current or future employment opportunities. If, however, management is exiting the market, as may be common during a time of heavy takeover activity such as during the 1980s,[55] or if the one-time payoff from self-dealing is so great that management is willing to risk a forced market exit, then managers will have reduced concern for the reputational impact of their actions.[56]

When discussing the role of reputation as a monitoring device in the vineyard hypothetical, I also discussed with the class the notion that the effectiveness of reputation as a constraint on misbehavior is dependent on an awareness by future employers of the agent's reputation for shirking. In the public corporation setting, this is equivalent to an acknowledgment that in order for the markets for corporate control and managerial labor to constrain managerial shirking effectively, the market must efficiently price for management misbehavior.[57]

At this point, professors have the option of introducing students to the Efficient Capital Markets Hypothesis (ECMH) and the debate surrounding it.[58] ECMH is a theory concerning the adjustment of

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[55] This phenomenon is known as a "final period" problem. In the final period, reputational forces are unlikely to constrain those exiting the market, as they might in the case of repeat players. *See* Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 619 (1984) (noting that investment bankers are more likely than issuers to be repeat players in capital markets and, consequently, can overcome many final period problems through signaling value of transaction to purchaser).

[56] Professor Bebchuk has argued that the markets for corporate control and managerial labor are imperfect monitoring devices even when there are no final period problems. *See* Bebchuk, *supra* note 52, at 1462-63 (stating that "[t]he likelihood is small that the limited reduction in share value would lead to a takeover bid or proxy contest that otherwise would not have occurred. Consequently, the market for corporate control cannot be relied upon to discourage managers from seeking value-decreasing rules with respect to issues that are significantly redistributive"); *id.* at 1465 (arguing that "the effects of a reduction in share value on future employment and promotion are unlikely to be substantial enough to discourage top managers from seeking value-decreasing rules that are significantly redistributive in their favor").

[57] Gilson, *supra* note 18, at 842.

[58] I normally prefer to introduce students to the idea that some information may be reflected in stock prices without specific reference to ECMH. Apparently other professors also follow this approach. *See, e.g.*, WILLIAM A. KLEIN & J. MARK RAMSEYER, REVISED TEACHER'S MANUAL FOR CASES AND MATERIALS ON BUSINESS ASSOCIATIONS 167 (1997) (noting that

security prices to different levels of relevant information.[59] While the semi-strong form of ECMH was once so widely accepted that its validity went largely unquestioned,[60] there is today a lively ongoing debate as to the descriptive power of ECMH.[61] In addition to the debate over stock market efficiency generally, some observers have argued that, regardless of the extent to which stock markets accurately reflect other types of relevant information, there is little empirical evidence that the stock market accurately prices management actions or legal developments (that is, changes to the "contract") that may be harmful to shareholders.[62]

Through this simple exercise, it is possible to introduce students to many of the essential elements of a Business Associations course. Throughout the semester, I return to these issues in more detail, always bringing the students back to a comparison with the two-person hypothetical vineyard firm in order to ground more complex topics in a familiar setting.

I conclude the semester with a discussion and review of some of the important theoretical issues examined during the semester:

Professor Klein discusses the incorporation of information into share price without direct reference to ECMH).

[59] Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383, 383 (1970). The three "forms" of ECMH, weak, semi-strong and strong, describe the reaction of security prices to three different types of information—historical security prices, other publicly available information, and relevant non-public information, respectively. *Id.*

[60] *See, e.g.*, Gilson & Kraakman, *supra* note 55, at 549 (stating that, "[o]f all recent developments in financial economics, the efficient capital market hypothesis ('ECMH') has achieved the widest acceptance by the legal culture."); Michael C. Jensen, *Some Anomalous Evidence Regarding Market Efficiency*, 6 J. FIN. ECON. 95 (1978) (stating author's belief that "there is no other proposition in economics which has more solid empirical evidence supporting it than the Efficient Market Hypothesis").

[61] *See generally* Lawrence A. Cunningham, *From Random Walks to Chaotic Crashes: The Linear Genealogy of the Efficient Capital Market Hypothesis*, 62 GEO. WASH. L. REV. 546, 551 (1994) (arguing that ECMH is false, and that chaos theory is superior to both ECMH and noise theory in explaining stock market crashes and offering policy justifications for many corporate and securities law doctrines); Eugene F. Fama, *Efficient Capital Markets: II*, 46 J. FIN. 1575 (1991) (summarizing 20 years of efficient capital markets research and concluding that, while joint-hypothesis problem makes empirical testing of ECMH problematic, market efficiency literature "has improved our understanding of the behavior of security returns"); Andrei Scheifer & Lawrence H. Summers, *The Noise Trader Approach to Finance*, 4 J. ECON. PERSP. 19 (1990) (arguing that many assumptions on which ECMH is based are unrealistic and pursuing noise trading theory as alternative to efficient markets approach).

[62] *See, e.g.*, Brudney, *supra* note 46, at 1411 (arguing that empirical evidence fails to support argument that efficient market exists for managerial competence).

What is and what should be the role of business organizations in society? For whose benefit should business institutions be run? Once we determine what the role of business organizations should be, how do we ensure that management avidly pursues that agenda? Will market forces suffice, or are legal rules necessary?

I again discuss with students the five mechanisms examined throughout the semester by which management's attempts to deviate from the settled purpose and agenda of the corporation are typically constrained: shareholder voting, boards of directors, employment contracts, market forces, and legal rules. I reiterate the imperfections associated with each of these devices and remind students that, although each device is imperfect, each may be useful, and all are frequently employed as monitoring devices in large business enterprises. Accordingly, intra-firm relations are governed by a mix of various monitoring devices that can run a continuum from sole reliance on market forces, as advocated by the most ardent contractarians, to strict legal rules that govern management behavior, as advocated many years ago by Professors Berle and Means and championed by various commentators ever since.[63] The extent to which each student—or each lawyer, legislator, judge, or corporate scholar—believes that the United States system has opted for the most effective point along that continuum will depend on the theory of the firm adopted by the individual. Finally, comparisons with the laws and informal norms governing business enterprises in other countries remind us that the United States's approach is not the only workable solution, nor, perhaps, the best one.

Many of my students—like law students everywhere—enroll in the Business Associations class with little or no knowledge of business enterprises and the laws that govern them. Most have never owned securities, do not understand the difference between an officer and a director, and consider the *Wall Street Journal* incomprehensible gibberish. The ability to conclude the semester with a rich and sophisticated discussion of such matters as the role that business enterprises should play in our society and the impact of institutional investors, global competition, and the rising trend in

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[63] BERLE & MEANS, *supra* note 53.

"socially responsible" investing, is a source of great pride—for me and for them. It is these discussions that affirm my decision to once again teach, for the eighth time in five years, the "basic course."

As noted by many of my fellow speakers at this conference, teaching Business Associations is a difficult and often thankless job. Because it is a "bar course," many of our students have no genuine interest in the subject matter. Because it is an introductory course, most of our students have not yet acquired the necessary background for an intellectual debate of the more sophisticated topics that are our primary scholarly interests as academicians. Nevertheless, the right approach can render the basic course a deeply rewarding experience for professor and student alike. Business organizations control an immense amount of wealth and power in this country. Understanding how the participants in those organizations interact with each other and with the rest of society enables students to function as more able lawyers, voters and community members long after their knowledge of such minutiae as the Delaware code's approach to written shareholder consents has faded.